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Getting a fairer share – China's income inequality improving but still some long term challenges

NAB Group Economics

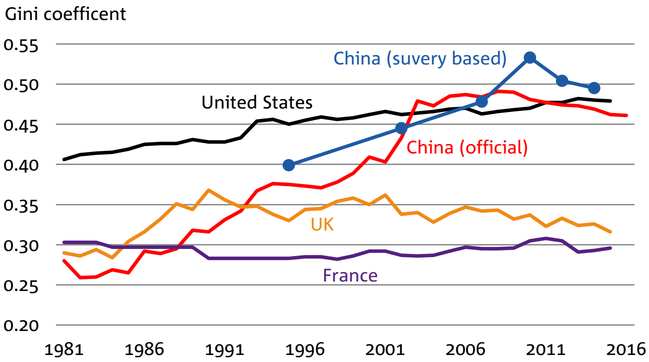
There has been an increased focus on inequality in income and wealth in major economies in recent times, with these themes influencing the outcome of the 2016 US Presidential Election and having an impact in this year's European elections – supporting the rise of populist candidates. China's income inequality grew rapidly as the country industrialised, but has narrowed more recently, a positive for both social stability and the transition towards a consumption based economy.

HOW UNEQUAL IS CHINA'S INCOME DISTRIBUTION?

The most common measure of income inequality is the Gini coefficient – which measures the statistical dispersion of income across the population on a scale from 0 to 1 (with higher values indicating higher inequality). Over the past thirty years, this measure has dramatically deteriorated in China, as the gains of the country's rapid industrialisation disproportionally accrued to the coastal provinces. The official estimate produced by the National Bureau of Statistics suggests the Gini coefficient rose from 0.29 in 1986 (similar to the level in France at this time) to 0.487 in 2006 (a level above the very income unequal United States). That said, the official measure peaked in 2008 and has gradually started to decline (down to 0.461 in 2016).

GINI COEFFICIENT

China's inequality high by international standards



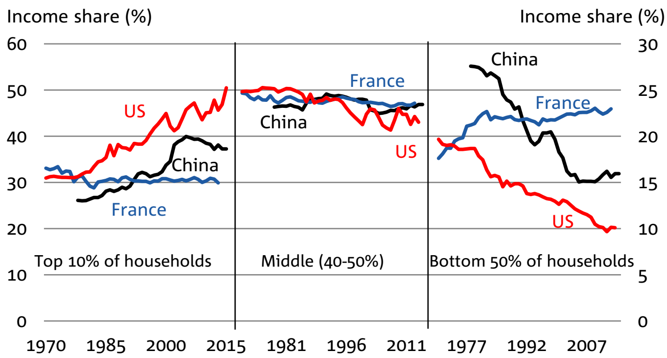
Source: Datastream, CEIC, Caixin, Vox.EU, NAB Economics

Unofficial estimates – based on long term longitudinal household surveys – suggest that China's income inequality was more severe than the official measure, peaking at a very high 0.533 in 2010, before retreating a little in 2012 and 2014.

Although these measures suggest that trends in income inequality have improved over the past decade or so, it is worth noting that income inequality remains high, and a cause for concern. A widely accepted rule of thumb is that Gini coefficients above 0.4 indicate potential for significant socio-political disorder.

GINI COEFFICIENT

China's inequality high by international



Source: World Wealth & Income Database, NAB Economics

Other data also point towards an improving trend in income distribution. According to data from the World Wealth & Income Database, the top 10% of Chinese households accounted for around 37% of total income in 2015 – down from a peak of 40% in 2005. While the share of the bottom 50% of households increased slightly over this period, the bulk of the gains went to the middle – up from 45% to 47%.

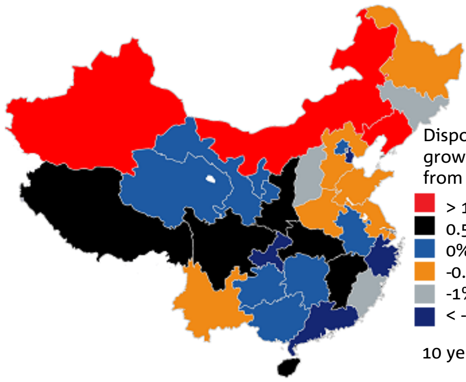
Date **March 2017** | Author **Gerard Burg** – Senior Economist – Asia

Similarly, regional trends point to the gradual improvement in income distribution. On a per capita basis, urban disposable incomes are highest in Beijing and the coastal provinces stretching from Shandong to Guangdong. However, these regions have generally recorded slower rates of growth over the past decade, meaning that lower income provinces have gradually reduced the gap.

PROVINCIAL INCOME INEQUALITY

Coastal provinces have the highest incomes

Income growth faster inland



WHAT HAS BEEN DRIVING THE IMPROVEMENT IN EQUALITY?

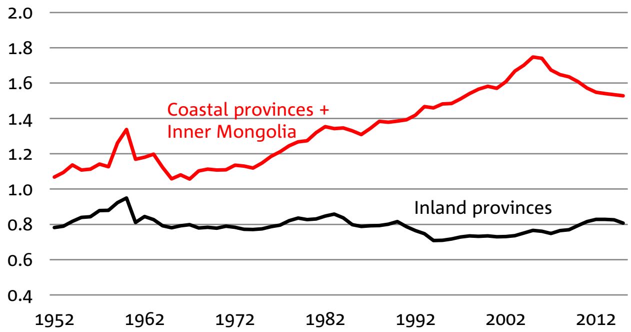
A range of factors have contributed to the narrowing in China's income inequality in recent years – including policy measures implemented by governments and broad demographic and development trends.

Minimum wage regulations were introduced in 2004, and helped to improve income distribution as compliance with the legislation increased over the past decade. The disparity between urban and rural incomes has lessened as medical insurance and social security programs were introduced in rural areas between 2004 and 2009, along with tightening rural labour markets, due to ongoing urbanisation and demographic changes.

Similarly, government policy has favoured the economic development of inland provinces, particularly through infrastructure projects. This has resulted in higher rates of economic growth in these regions – with the disparity in per capita gross domestic product between the coastal provinces and the rest of the country peaking in 2005 and gradually declining since – back to levels previous seen during the mid-1990s.

GDP PER CAPITA

Gap between coastal and inland provinces starting to narrow



Source: CEIC, NAB Economics

China's long term demographic changes are likely to have been a major factor. In the early stages of China's industrialisation, there was a vast quantity of low cost labour – particularly in rural areas. Large scale migration to major cities kept wages low (albeit higher than in rural areas), while benefits accrued to capital owners – contributing to the deterioration in income equality.

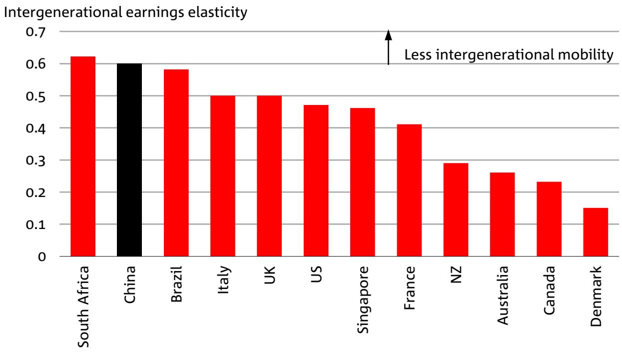
In recent times, this surplus rural labour has largely evaporated, with the total rural population fell to 590 million at the end of 2016 (its lowest level since 1964), and wages have started to climb – what is known in development economics as a Lewis turning point. Some estimates suggest that this occurred in 2010, while others argue the full effect is still to come. Passing the Lewis turning point results in a greater labour share of output, further reducing income inequality.

CONCLUSIONS: CHALLENGES IN LOWERING INEQUALITY

Although trends in income inequality have improved in recent years, it is worth remembering that the overall level of inequality remains extremely high – particularly in comparison to the majority of advanced economies. Further improvement will help to support China's economic transition from an investment based economy to a consumption based one. There are some structural constraints that could limit further reductions in inequality. China's intergeneration mobility – the capacity for individuals to move up into higher income groups – is particularly low, and has worsened over time. A major contributor to this has been education – with higher income households locking in access to the highest quality education, perpetuating a cycle of disadvantage for lower income households. Greater government investment in education may be necessary to improve intergenerational mobility.

INTERGENERATIONAL MOBILITY

Access to education constrains mobility in China



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